Notes to Consolidated Financial Statements

7. Long-Term Debt

In February 2006, the Company issued $500 million of senior floating interest rate notes due 2009 (the "2009 Notes"), $3.0 billion of 5.25% senior notes due 2011 (the "2011 Notes") and $3.0 billion of 5.50% senior notes due 2016 (the "2016 Notes"), for an aggregate principal amount of $6.5 billion. The 2011 Notes and the 2016 Notes are redeemable by the Company at any time, subject to a make-whole premium. To achieve its interest rate objectives, the Company entered into $6.0 billion notional amount of interest rate swaps. In effect, these swaps convert the fixed interest rates of the 2011 Notes and the 2016 Notes to floating interest rates based on the London Interbank Offered Rate (LIBOR). Gains and losses in the fair value of the interest rate swaps offset changes in the fair value of the underlying debt. See Note 8 to the Consolidated Financial Statements. The Company was in compliance with all debt covenants as of July 29, 2006.

The following table summarizes the Company's long-term debt as of July 29, 2006 (in millions, except percentages):

	Amount	Effective Rate[1]
Senior notes:		
2009 Notes	$ 500	5.27%
2011 Notes	3,000	5.39%
2016 Notes	3,000	5.62%
Total senior notes	6,500	
Other notes	5	
Unamortized discount	(18)	
Fair value adjustment	(155)	
Total	$ 6,332	

(1) The effective rates for the 2011 Notes and the 2016 Notes reflect the variable rate in effect as of July 29, 2006 on the interest rate swaps designated as fair value hedges of those notes, including the amortization of the discount.

Interest is payable quarterly on the 2009 Notes and semi-annually on the 2011 Notes and 2016 Notes. Interest expense, net of the effect of hedging, was $148 million for fiscal 2006 and was included in interest income, net in the Consolidated Statements of Operations. Cash paid for interest during fiscal 2006 was $6 million.

8. Commitments and Contingencies

Operating Leases

The Company leases office space in several U.S. locations. Outside the United States, larger sites include Australia, Belgium, Canada, China, France, Germany, India, Italy, Japan, and the United Kingdom. Rent expense totaled $181 million, $179 million, and $191 million in fiscal 2006, 2005, and 2004, respectively. Future annual minimum lease payments under all noncancelable operating leases with an initial term in excess of one year as of July 29, 2006 were as follows (in millions):

Fiscal Year	Amount
2007	$ 233
2008	159
2009	121
2010	105
2011	91
Thereafter	506
Total	$1,215

Purchase Commitments with Contract Manufacturers and Suppliers

The Company purchases components from a variety of suppliers and uses several contract manufacturers to provide manufacturing services for its products. During the normal course of business, in order to manage manufacturing lead times and help ensure adequate component supply, the Company enters into agreements with contract manufacturers and suppliers that either allow them to procure inventory based upon criteria as defined by the Company or that establish the parameters defining the Company's requirements. In certain instances, these agreements allow the Company the option to cancel, reschedule, and adjust the Company's requirements based on its business needs prior to firm orders being placed. Consequently, only a portion of the Company's reported purchase commitments arising from these agreements are firm, noncancelable, and unconditional commitments. As of July 29, 2006, the Company had total purchase commitments for inventory of approximately $2.0 billion, compared with $954 million as of July 30, 2005.

In addition to the above, the Company records a liability for firm, noncancelable, and unconditional purchase commitments for quantities in excess of its future demand forecasts consistent with the Company's allowance for inventory. As of July 29, 2006, the liability for these purchase commitments was $148 million, compared with $87 million as of July 30, 2005, and was included in other accrued liabilities.

Other Commitments

The Company has entered into an agreement to invest approximately $800 million in venture funds managed by SOFTBANK that are required to be funded on demand. The total commitment is to be invested in venture funds and as senior debt with entities as directed by SOFTBANK. The Company's commitment to fund the senior debt is contingent upon the achievement of certain agreed-upon milestones. As of July 29, 2006, the Company had invested $523 million in the venture funds pursuant to the commitment, compared with $414 million as of July 30, 2005. In addition, as of July 29, 2006, the Company had invested $49 million in the senior debt pursuant to the commitment, all of which has been repaid. As of July 30, 2005, the Company had invested $49 million in the senior debt pursuant to the commitment, of which $47 million had been repaid.

The Company also has certain other funding commitments related to its privately held investments that are based on the achievement of certain agreed-upon milestones. The funding commitments were approximately $34 million as of July 29, 2006, compared with approximately $56 million as of July 30, 2005.

Variable Interest Entities

In the ordinary course of business, the Company has investments in privately held companies and provides financing to certain customers through its wholly owned subsidiaries, which may be considered to be variable interest entities. The Company has evaluated its investments in privately held companies and customer financings and determined that there were no significant unconsolidated variable interest entities as of July 29, 2006.

Guarantees and Product Warranties

The Company's guarantees issued that are subject to recognition and disclosure requirements as of July 29, 2006 and July 30, 2005 were not material. The following table summarizes the activity related to the product warranty liability during fiscal 2006 and 2005 (in millions):

	July 29, 2006	July 30, 2005
Balance at beginning of fiscal year	$ 259	$ 239
Provision for warranties issued	395	411
Fair value of warranty liability acquired from Scientific-Atlanta	44	—
Payments	(389)	(391)
Balance at end of fiscal year	$ 309	$ 259

The Company accrues for warranty costs as part of its cost of sales based on associated material product costs, labor costs for technical support staff, and associated overhead. The products sold are generally covered by a warranty for periods ranging from 90 days to five years, and for some products the Company provides a limited lifetime warranty.

In the normal course of business, the Company indemnifies other parties, including customers, lessors, and parties to other transactions with the Company, with respect to certain matters. The Company has agreed to hold the other parties harmless against losses arising from a breach of representations or covenants, or out of intellectual property infringement or other claims made against certain parties. These agreements may limit the time within which an indemnification claim can be made and the amount of the claim. In addition, the Company has entered into indemnification agreements with its officers and directors, and the Company's bylaws contain similar indemnification obligations to the Company's agents.

It is not possible to determine the maximum potential amount under these indemnification agreements due to the limited history of prior indemnification claims and the unique facts and circumstances involved in each particular agreement. Historically, payments made by the Company under these agreements have not had a material effect on the Company's operating results, financial position, or cash flows.

Derivative Instruments

The Company uses derivative instruments to manage exposures to foreign currency, interest rate, and equity security price risks. The Company's objective in holding derivatives is to reduce the volatility of earnings and cash flows associated with changes in foreign currency, interest rates, and equity security prices. The Company's derivatives expose it to credit risk to the extent that the counterparties may be unable to meet the terms of the agreement. The Company seeks to reduce such risks by limiting its counterparties to major financial institutions. In addition, the potential risk of loss with any one counterparty resulting from this type of credit risk is monitored. Management does not expect material losses as a result of defaults by counterparties.

Foreign Currency Derivatives The Company conducts business globally in numerous currencies. As such, it is exposed to adverse movements in foreign currency exchange rates. The Company enters into foreign exchange forward contracts to reduce the short-term effects of foreign currency fluctuations on foreign currency receivables, investments, and payables. The gains and losses on the foreign exchange forward contracts offset the transaction gains and losses on foreign currency receivables, investments, and payables recognized in earnings.

The Company does not enter into foreign exchange forward contracts for trading purposes. Gains and losses on the contracts are included in other income, net, in the Consolidated Statements of Operations and offset foreign exchange gains and losses from the revaluation of intercompany balances or other current assets, investments, or liabilities denominated in currencies other than the functional currency of the reporting entity. The Company's foreign exchange forward contracts related to current assets and liabilities generally range from one to three months in original maturity. Additionally, the Company has entered into foreign exchange forward contracts with maturities of up to two years related to long-term customer financings. The foreign exchange contracts related to investments generally have maturities of less than one year.

The Company periodically hedges certain foreign currency forecasted transactions related to certain operating expenses with currency options and forward contracts. These transactions are designated as cash flow hedges. The effective portion of the derivative's gain or loss is initially reported as a component of accumulated other comprehensive income and subsequently reclassified into earnings when the hedged exposure affects earnings. The ineffective portion, if any, of the gain or loss is reported in earnings immediately. These currency option contracts generally have maturities of less than 18 months. The Company does not purchase currency options for trading purposes. Foreign exchange forward and option contracts are summarized as follows (in millions):

July 29, 2006	Notional Amount	Fair Value
Forward contracts:		
Purchased	**$1,376**	**$ (2)**
Sold	**$ 554**	**$ (3)**
Option contracts:		
Purchased	**$ 591**	**$20**
Sold	**$ 573**	**$ (2)**

July 30, 2005	Notional Amount	Fair Value
Forward contracts:		
Purchased	$ 1,011	$ (5)
Sold	$ 450	$ 9
Option contracts:		
Purchased	$ 1,028	$ 10
Sold	$ 1,002	$ (7)

Interest Rate Derivatives The Company's primary objective for holding fixed income securities is to achieve an appropriate investment return consistent with preserving principal and managing risk. To realize these objectives, the Company may utilize interest rate swaps or other derivatives designated as fair value or cash flow hedges. The Company has entered into $1.0 billion of interest rate swaps designated as fair value hedges of its investment portfolio. Under these interest rate swap contracts, the Company makes fixed-rate interest payments and receives interest payments based on LIBOR. The effect of these swaps is to convert fixed-rate returns to floating-rate returns based on LIBOR for a portion of the Company's fixed income portfolio. The gains and losses related to changes in the value of the interest rate swaps are included in other income, net, in the Consolidated Statements of Operations and offset the changes in fair value of the underlying hedged investment. As of July 29, 2006 and July 30, 2005, the fair values of the interest rate swaps designated as hedges of the Company's investments were $45 million and $15 million, respectively, and were reflected in prepaid expenses and other current assets in the Consolidated Balance Sheets.

In conjunction with its issuance of fixed-rate senior notes in February 2006, the Company entered into $6.0 billion of interest rate swaps designated as fair value hedges of the fixed-rate debt. Under these interest rate swap contracts, the Company receives fixed-rate interest payments and makes interest payments based on LIBOR. The effect of these swaps is to convert fixed-rate interest expense to floating-rate interest expense based on LIBOR. The gains and losses related to changes in the value of the interest rate swaps are included in other income, net, in the Consolidated Statements of Operations and offset the changes in fair value of the underlying debt. As of July 29, 2006 the fair value of the interest rate swaps was $155 million and was reflected in other long-term liabilities in the Consolidated Balance Sheets.

Equity Derivatives The Company maintains a portfolio of publicly traded equity securities which are subject to price risk. The Company may hold equity securities for strategic purposes or to diversify the Company's overall investment portfolio. To manage its exposure to changes in the fair value of certain equity securities, the Company may, from time to time, enter into equity derivative contracts. As of July 29, 2006, the Company had entered into forward sale and option agreements on certain publicly traded equity securities designated as fair value hedges. The gains and losses due to changes in the value of the hedging instruments are included in other income, net, in the Consolidated Statements of Operations and offset the change in the fair value of the underlying hedged investment. As of July 29, 2006, the notional and fair value amounts of the derivatives were $164 million and $93 million, respectively. As of July 30, 2005, the notional and fair value amounts of the derivatives were $198 million and $19 million, respectively.

Legal Proceedings

Beginning on April 20, 2001, a number of purported shareholder class action lawsuits were filed in the United States District Court for the Northern District of California against the Company and certain of its officers and directors. The lawsuits were consolidated, and the consolidated action is purportedly brought on behalf of those who purchased the Company's publicly traded securities during an alleged class period of November 10, 1999 through February 6, 2001. Plaintiffs allege that defendants have made false and misleading statements, purport to assert claims for violations of the federal securities laws, and seek unspecified compensatory damages and other relief. On August 18, 2006, the Company announced an agreement to resolve the litigation. Pursuant to that agreement (which is subject to final documentation and court approval), liability insurers will pay $91.75 million to the plaintiffs in resolution of all claims against the Company and its officers and directors. If the settlement is approved by the Court, the settlement fund, less fees and expenses, will be distributed to purchasers of Cisco common stock between November 10, 1999 and February 6, 2001 who timely file valid proofs of claim under procedures to be implemented by the Court. The Company and the individual defendants continue to deny all allegations in the lawsuit.

On February 16, 2005, a purported shareholder derivative lawsuit was filed in the Superior Court of California, County of Santa Clara, against various of the Company's officers and directors and naming the Company as a nominal defendant. The lawsuit includes derivative and class claims for breach of fiduciary duty, unjust enrichment, constructive trust and violations of the California Corporations Code, is based upon allegations of wrongdoing in connection with option grants and compensation to officers and directors, the timing of option grants, and the Company's share repurchase plan, and seeks unspecified compensation and other damages, rescission of options and other relief.

In addition, the Company is subject to legal proceedings, claims, and litigation arising in the ordinary course of business, including intellectual property litigation. While the outcome of these matters is currently not determinable, the Company does not expect that the ultimate costs to resolve these matters will have a material adverse effect on the Company's consolidated financial position, results of operations, or cash flows.

9. Shareholders' Equity

Stock Repurchase Program

In September 2001, the Company's Board of Directors authorized a stock repurchase program. As of July 29, 2006, the Company's Board of Directors had authorized an aggregate repurchase of up to $40 billion of common stock under this program. During fiscal 2006, the Company repurchased and retired 435 million shares of Cisco common stock at an average price of $19.07 per share for an aggregate purchase price of $8.3 billion. As of July 29, 2006, the Company had repurchased and retired 1.9 billion shares of Cisco common stock at an average price of $18.36 per share for an aggregate purchase price of $35.4 billion since inception of the stock repurchase program, and the remaining authorized amount for stock repurchases under this program was $4.6 billion with no termination date.

The purchase price for the shares of the Company's stock repurchased was reflected as a reduction to shareholders' equity. In accordance with Accounting Principles Board Opinion No. 6, "Status of Accounting Research Bulletins," the Company is required to allocate the purchase price of the repurchased shares as (i) a reduction to retained earnings until retained earnings are zero and then as an increase to accumulated deficit and (ii) a reduction of common stock and additional paid-in capital. Issuance of common stock and the tax benefit related to employee stock option plans are recorded as an increase to common stock and additional paid-in capital.

Preferred Stock

Under the terms of the Company's Articles of Incorporation, the Board of Directors may determine the rights, preferences, and terms of the Company's authorized but unissued shares of preferred stock.

Comprehensive Income

The components of comprehensive income are as follows (in millions):

Years Ended	July 29, 2006	July 30, 2005	July 31, 2004
Net income	$5,580	$5,741	$4,401
Other comprehensive income:			
Change in unrealized gains and losses on investments, net of tax benefit (expense) of $57, $(61), and $42 in fiscal 2006, 2005, and 2004, respectively	(64)	(25)	(77)
Other	61	10	19
Other comprehensive income before minority interest	5,577	5,726	4,343
Change in minority interest	1	77	(84)
Total	$5,578	$5,803	$4,259

The Company consolidates its investment in a venture fund managed by SOFTBANK as it is the primary beneficiary as defined under FIN 46(R). As a result, the change in the unrealized gains and losses on the investments in the venture fund are recorded as a component of other comprehensive income and is reflected as a change in minority interest.

10. Employee Benefit Plans

Employee Stock Purchase Plan

The Company has an Employee Stock Purchase Plan, which includes its sub-plan, the International Employee Stock Purchase Plan (together, the "Purchase Plan"), under which 321.4 million shares of the Company's stock have been reserved for issuance. Eligible employees may purchase a limited number of shares of the Company's stock at a discount of up to 15% of the market value at either the subscription date or the purchase date, which is approximately six months after the subscription date. The Purchase Plan terminates on January 3, 2010. In fiscal 2006, 2005, and 2004, the shares issued under the Purchase Plan were 21 million, 19 million, and 26 million shares, respectively. At July 29, 2006, 99 million shares were available for issuance under the Purchase Plan.

Employee Stock Incentive Plans

Stock Incentive Plan Program Description As of July 29, 2006, the Company had four stock incentive plans: the 2005 Stock Incentive Plan (the "2005 Plan"), the 1996 Stock Incentive Plan (the "1996 Plan"), the 1997 Supplemental Stock Incentive Plan (the "Supplemental Plan"), and the Cisco Systems, Inc. SA Acquisition Long-Term Incentive Plan (the "Acquisition Plan"). The Company has, in connection with the acquisitions of various companies, assumed the stock incentive plans of the acquired companies or issued replacement share-based awards.

Share-based awards are designed to reward employees for their long-term contributions to the Company and provide incentives for them to remain with the Company. The number and frequency of share-based awards are based on competitive practices, operating results of the Company, and government regulations.

The maximum number of shares issuable over the term of the 2005 Plan is limited to 350 million shares. The 2005 Plan permits the granting of stock options, stock grants, stock units and stock appreciation rights to employees (including employee directors and officers) and consultants of the Company and its subsidiaries and affiliates, and nonemployee directors of the Company. Stock options granted under the 2005 Plan have an exercise price of at least 100% of the fair market value of the underlying stock on the grant date and expire no later than nine years from the grant date. The stock options will generally become exercisable for 20% of the option shares one year from the date of grant and then ratably over the following 48 months. The Compensation and Management Development Committee of the Board of Directors has the discretion to use a different vesting schedule. Stock appreciation rights may be awarded in combination with stock options or stock grants and such awards shall provide that the stock appreciation rights will not be exercisable unless the related stock options or stock grants are forfeited. Stock grants may be awarded in combination with nonstatutory stock options, and such awards may provide that the stock grants will be forfeited in the event that the related nonstatutory stock options are exercised.

The maximum number of shares issuable over the term of the 1996 Plan is limited to 2.5 billion shares. Stock options granted under the 1996 Plan have an exercise price equal of at least 100% of the fair market value of the underlying stock on the grant date and expire no later than nine years from the grant date. The stock options will generally become exercisable for 20% or 25% of the option shares one year from the date of grant and then ratably over the following 48 or 36 months, respectively. Certain other grants have utilized a 60-month ratable vesting schedule. In addition, the Board of Directors, or other committee administering the plan, has the discretion to use a different vesting schedule and has done so from time to time. Since the inception of the 1996 Plan, the Company has granted stock options to virtually all employees, and the majority has been granted to employees below the vice president level.

In 1997, the Company adopted the Supplemental Plan, under which stock options can be granted or shares can be directly issued to eligible employees. Officers and members of the Company's Board of Directors are not eligible to participate in the Supplemental Plan. Nine million shares have been reserved for issuance under the Supplemental Plan. All stock option grants have an exercise price equal to the fair market value of the underlying stock on the grant date. The Company no longer makes stock option grants or direct share issuances under the Supplemental Plan.

Effective upon completion of the Company's acquisition of Scientific-Atlanta, the Company adopted the Acquisition Plan. The Acquisition Plan constitutes an assumption, amendment, restatement and renaming of the 2003 Long-Term Incentive Plan of Scientific-Atlanta. The Acquisition Plan permits the grant of stock options, stock grants, stock units and stock appreciation rights to certain employees of the Company and its subsidiaries and affiliates who had been employed by Scientific-Atlanta or its subsidiaries. An aggregate of 14.8 million shares of the Company's common stock has been reserved for issuance under the Acquisition Plan on a discretionary basis, subject to limitations set forth in the Acquisition Plan.

Distribution and Dilutive Effect of Stock Options The following table illustrates the grant dilution and exercise dilution (in millions, except percentages):

Years Ended	July 29, 2006	July 30, 2005
Shares of common stock outstanding	6,059	6,331
Granted and assumed	230	244
Canceled/forfeited/expired	(84)	(65)
Net stock options granted	146	179
Grant dilution[1]	2.4%	2.8%
Exercised	136	93
Exercise dilution[2]	2.2%	1.5%

(1) The percentage for grant dilution is computed based on net stock options granted as a percentage of shares of common stock outstanding at the fiscal year end.

(2) The percentage for exercise dilution is computed based on stock options exercised as a percentage of shares of common stock outstanding at the fiscal year end.

Weighted-average basic and diluted shares outstanding for the year ended July 29, 2006 were 6.2 billion shares and 6.3 billion shares, respectively. Diluted shares outstanding include the dilutive effect of in-the-money options, which is calculated based on the average share price for each fiscal year using the treasury stock method. Under the treasury stock method, the amount that the employee must pay for exercising stock options, the amount of compensation cost for future service that the Company has not yet recognized, and the amount of tax benefits that would be recorded in additional paid-in capital when the award becomes deductible are assumed to be used to repurchase shares. In fiscal 2006, the dilutive effect of in-the-money employee stock options was approximately 117 million shares or 1.9% of the basic shares outstanding based on the Company's average share price of $19.00.

The Named Executive Officers represent the Company's Chief Executive Officer and the four other most highly paid executive officers whose salary and bonus for the years ended July 29, 2006 and July 30, 2005 were in excess of $100,000. The following table summarizes the options granted to the Named Executive Officers during the fiscal years indicated:

Years Ended	July 29, 2006	July 30, 2005
Stock options granted to the Named Executive Officers	3 million	4 million
Stock options granted to the Named Executive Officers as a percentage of net stock options granted	2.3%	2.2%
Stock options granted to the Named Executive Officers as a percentage of outstanding shares	0.05%	0.06%
Cumulative stock options held by Named Executive Officers as a percentage of total stock options outstanding	3.4%	4.1%

General Share-Based Award Information A summary of share-based award activity is as follows (in millions, except per-share amounts):

		STOCK OPTIONS OUTSTANDING	
	Share-Based Awards Available for Grant	Number Outstanding	Weighted-Average Exercise Price Per Share
BALANCE AT JULY 26, 2003	526	1,303	$ 25.29
Granted and assumed	(195)	195	20.00
Exercised	—	(96)	10.03
Canceled/forfeited/expired	52	(52)	32.33
Additional shares reserved	7	—	—
BALANCE AT JULY 31, 2004	390	1,350	25.34
Granted and assumed	(244)	244	18.70
Exercised	—	(93)	8.44
Canceled/forfeited/expired	63	(65)	31.63
Additional shares reserved	14	—	—
BALANCE AT JULY 30, 2005	223	1,436	25.02
Granted and assumed	(230)	230	18.21
Exercised	—	(136)	10.08
Canceled/forfeited/expired	79	(84)	29.53
Restricted stock granted	(6)	—	—
Additional shares reserved	398	—	—
BALANCE AT JULY 29, 2006	464	1,446	$25.08

The total pretax intrinsic value of stock options exercised during fiscal 2006 was $1.3 billion. The following table summarizes significant ranges of outstanding and exercisable options as of July 29, 2006 (in millions, except years and per-share amounts):

	STOCK OPTIONS OUTSTANDING				STOCK OPTIONS EXERCISABLE		
Range of Exercise Prices	Number Outstanding	Weighted-Average Remaining Contractual Life (in Years)	Weighted-Average Exercise Price Per Share	Aggregate Intrinsic Value	Number Exercisable	Weighted-Average Exercise Price Per Share	Aggregate Intrinsic Value
$ 0.01 – 13.04	198	3.90	$ 10.92	$ 1,420	152	$ 10.89	$1,072
13.05 – 17.70	182	4.73	15.90	397	146	15.80	334
17.71 – 18.57	222	6.98	18.05	36	62	18.48	2
18.58 – 19.31	181	7.08	19.14	—	64	19.13	—
19.32 – 20.53	204	5.77	19.86	—	124	19.98	—
20.54 – 38.06	187	3.67	26.08	—	149	27.13	—
38.07 – 72.56	272	2.89	54.39	—	272	54.40	—
Total	1,446	4.92	$25.08	$ 1,853	969	$28.53	$1,408

The aggregate intrinsic value in the preceding table represents the total pretax intrinsic value based on stock options with an exercise price less than the Company's closing stock price of $18.08 as of July 29, 2006, which would have been received by the option holders had those option holders exercised their options as of that date. The total number of in-the-money stock options exercisable as of July 29, 2006 was 303 million. As of July 30, 2005, 906 million outstanding stock options were exercisable and the weighted-average exercise price was $28.80.

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The following table presents the option exercises for the year ended July 29, 2006, and option values as of that date for the Named Executive Officers (in millions):

			NUMBER OF SECURITIES UNDERLYING UNEXERCISED OPTIONS AT JULY 29, 2006		INTRINSIC VALUE OF UNEXERCISED IN-THE-MONEY OPTIONS AT JULY 29, 2006	
	Number of Shares Acquired on Exercise	Value Realized	Exercisable	Unexercisable	Exercisable	Unexercisable
Named Executive Officers	7	$88	39	10	$52	$ 8

Valuation and Expense Information Under SFAS 123(R) On July 31, 2005, the Company adopted SFAS 123(R), which requires the measurement and recognition of compensation expense for all share-based payment awards made to the Company's employees and directors including employee stock options and employee stock purchases based on estimated fair values. Stock-based compensation expense related to employee stock options and employee stock purchases under SFAS 123(R) for fiscal 2006 was allocated as follows (in millions except per-share amounts):

	Amount
Cost of sales—product	$ 50
Cost of sales—service	112
Stock-based compensation expense included in cost of sales	162
Research and development	346
Sales and marketing	427
General and administrative	115
Stock-based compensation expense included in operating expenses	888
Total stock-based compensation expense related to employee stock options and employee stock purchases	1,050
Tax benefit	(294)
Stock-based compensation expense related to employee stock options and employee stock purchases, net of tax	$ 756
Effect of SFAS 123(R) on basic earnings per share	$ 0.12
Effect of SFAS 123(R) on diluted earnings per share	$ 0.12

Stock-based compensation expense of $87 million related to acquisitions and investments for fiscal 2006 is disclosed in Note 3 and is not included in the above table. There was no stock-based compensation expense recognized for fiscal 2005 and 2004 other than as related to acquisitions and investments. As of July 29, 2006, total compensation cost related to nonvested share-based awards not yet recognized was $2.0 billion, including stock-based compensation relating to acquisition and investments, which is expected to be recognized over the next 39 months on a weighted-average basis.

The table below reflects net income and diluted net income per share for fiscal 2006 compared with the pro forma information for fiscal 2005 and 2004 (in millions except per-share amounts):

Years Ended	July 29, 2006	July 30, 2005	July 31, 2004
Net income—as reported for prior fiscal years[1]	N/A	$ 5,741	$ 4,401
Stock-based compensation expense related to employee stock options and employee stock purchases	$ (1,050)	(1,628)	(2,025)
Tax benefit	$ 294	594	810
Stock-based compensation expense related to employee stock options and employee stock purchases, net of tax[2]	$ (756)	(1,034)	(1,215)
Net income, including the effect of stock-based compensation expense[3]	$ 5,580	$ 4,707	$ 3,186
Diluted net income per share—as reported for prior fiscal years[1]	N/A	$ 0.87	$ 0.62
Diluted net income per share, including the effect of stock-based compensation expense[3]	$ 0.89	$ 0.71	$ 0.45

(1) Net income and net income per share prior to fiscal 2006 did not include stock-based compensation expense related to employee stock options and employee stock purchases under SFAS 123 because the Company did not adopt the recognition provisions of SFAS 123.

(2) Stock-based compensation expense prior to fiscal 2006 is calculated based on the pro forma application of SFAS 123.

(3) Net income and net income per share prior to fiscal 2006 represents pro forma information based on SFAS 123.

The tax benefit in the table above includes the effect of U.S. tax regulations effective in fiscal 2005 that require intercompany reimbursement of certain stock-based compensation expenses. Upon adoption of SFAS 123(R), the Company began estimating the value of employee stock options and employee stock purchases on the date of grant using a lattice-binomial model. Prior to the adoption of SFAS 123(R), the value of each employee stock option and employee stock purchase was estimated on the date of grant using the Black-Scholes model for the purpose of the pro forma financial information required in accordance with SFAS 123.

The Company's employee stock options have various restrictions including vesting provisions and restrictions on transfer and hedging, among others, and are often exercised prior to their contractual maturity. Lattice-binomial models are more capable of incorporating the features of the Company's employee stock options than closed-form models such as the Black-Scholes model. The use of a lattice-binomial model requires extensive actual employee exercise behavior data and a number of complex assumptions including expected volatility, risk-free interest rate, expected dividends, kurtosis, and skewness. The weighted-average estimated values of employee stock options granted and employee stock purchases during fiscal 2006 were $5.15 and $4.66 per share, respectively, using the lattice-binomial model with the following weighted-average assumptions:

	Employee Stock Option Plans	Employee Stock Purchase Plan
Expected volatility	23.7%	27.5%
Risk-free interest rate	4.3%	3.4%
Expected dividend	0.0%	0.0%
Kurtosis	4.3	N/A
Skewness	(0.62)	N/A

The Company used the implied volatility for two-year traded options on the Company's stock as the expected volatility assumption required in the lattice-binomial model, consistent with SFAS 123(R) and SAB 107. Prior to fiscal 2006, the Company had used its historical stock price volatility in accordance with SFAS 123 for purposes of its pro forma information. The selection of the implied volatility approach was based upon the availability of actively traded options on the Company's stock and the Company's assessment that implied volatility is more representative of future stock price trends than historical volatility.

The risk-free interest rate assumption is based upon observed interest rates appropriate for the term of the Company's employee stock options. The dividend yield assumption is based on the history and expectation of dividend payouts. The estimated kurtosis and skewness are technical measures of the distribution of stock price returns, which affect expected employee exercise behaviors that are based on the Company's stock price return history as well as consideration of academic analyses.

The expected life of employee stock options represents the weighted-average period the stock options are expected to remain outstanding and is a derived output of the lattice-binomial model. The expected life of employee stock options is impacted by all of the underlying assumptions and calibration of the Company's model. The lattice-binomial model assumes that employees' exercise behavior is a function of the option's remaining vested life and the extent to which the option is in-the-money. The lattice-binomial model estimates the probability of exercise as a function of these two variables based on the entire history of exercises and cancellations on all past option grants made by the Company. The expected life for option grants made during fiscal 2006 derived from the lattice-binomial model was 6.6 years.

Because stock-based compensation expense recognized in the Consolidated Statement of Operations for fiscal 2006 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Forfeitures were estimated based on historical experience and the Company expects forfeitures to be 3% annually. In the Company's pro forma information required under SFAS 123 for the periods prior to fiscal 2006, the Company accounted for forfeitures as they occurred.

Pro Forma Information Under SFAS 123 for Fiscal Years Prior to 2006 Pro forma information regarding option grants made to the Company's employees and directors and employee stock purchases is as follows (in millions, except per-share amounts):

Years Ended	July 30, 2005	July 31, 2004
Net income—as reported	$ 5,741	$ 4,401
Stock-based compensation expense	(1,628)	(2,025)
Tax benefit	594	810
Stock-based compensation expense, net of tax	(1,034)	(1,215)
Net income—pro forma	$ 4,707	$ 3,186
Basic net income per share—as reported	$ 0.88	$ 0.64
Diluted net income per share—as reported	$ 0.87	$ 0.62
Basic net income per share—pro forma	$ 0.73	$ 0.47
Diluted net income per share—pro forma	$ 0.71	$ 0.45

The weighted-average estimated value of employee stock options granted during fiscal 2005 and fiscal 2004 were $6.19 and $8.77, respectively, using the Black-Scholes model with the following weighted-average assumptions:

	EMPLOYEE STOCK OPTION PLANS		EMPLOYEE STOCK PURCHASE PLAN	
	July 30, 2005	July 31, 2004	July 30, 2005	July 31, 2004
Expected volatility	39.6%	40.0%	33.2%	43.2%
Risk-free interest rate	3.6%	3.9%	2.0%	2.8%
Expected dividend	0.0%	0.0%	0.0%	0.0%
Expected life (in years)	3.3	5.6	0.6	1.9

Prior to fiscal 2006, the Company used an option-pricing model to indirectly estimate the expected life of the stock options. The expected life and expected volatility of the stock options were based upon historical and other economic data trended into the future. Forfeitures of employee stock options were accounted for on an as-incurred basis.

Accuracy of Fair Value Estimates The Company uses third-party analyses to assist in developing the assumptions used in, as well as calibrating, its lattice-binomial model. The Company is responsible for determining the assumptions used in estimating the fair value of its share-based payment awards.

The Company's determination of fair value of share-based payment awards on the date of grant using an option-pricing model is affected by the Company's stock price as well as assumptions regarding a number of highly complex and subjective variables. These variables include, but are not limited to the Company's expected stock price volatility over the term of the awards, and actual and projected employee stock option exercise behaviors. Option-pricing models were developed for use in estimating the value of traded options that have no vesting or hedging restrictions and are fully transferable. Because the Company's employee stock options have certain characteristics that are significantly different from traded options, and because changes in the subjective assumptions can materially affect the estimated value, in management's opinion, the existing valuation models may not provide an accurate measure of the fair value of the Company's employee stock options. Although the fair value of employee stock options is determined in accordance with SFAS 123(R) and SAB 107 using an option-pricing model, that value may not be indicative of the fair value observed in a willing buyer/willing seller market transaction.

Employee 401(k) Plans

The Company sponsors the Cisco Systems, Inc. 401(k) Plan (the "Plan") to provide retirement benefits for its employees. As allowed under Section 401(k) of the Internal Revenue Code, the Plan provides tax-deferred salary contributions for eligible employees. The Plan allows employees to contribute from 1% to 25% of their annual compensation to the Plan on a pretax and after-tax basis. Employee contributions are limited to a maximum annual amount as set periodically by the Internal Revenue Code. The Company matches pretax employee contributions up to 50% of the first 6% of eligible earnings that are contributed by employees. Therefore, the maximum matching contribution that the Company may allocate to each participant's account will not exceed $6,600 for the 2006 calendar year due to the $220,000 annual limit on eligible earnings imposed by the Internal Revenue Code. All matching contributions vest immediately. The Company's matching contributions to the Plan totaled $96 million, $84 million, and $81 million in fiscal 2006, 2005, and 2004, respectively.

The Plan allows employees who meet the age requirements and reach the Plan contribution limits to make a catch-up contribution not to exceed the lesser of 50% of their eligible compensation or the limit set forth in the Internal Revenue Code. The catch-up contributions are not eligible for matching contributions. In addition, the Plan provides for discretionary profit-sharing contributions as determined by the Board of Directors. Such contributions to the Plan are allocated among eligible participants in the proportion of their salaries to the total salaries of all participants. There were no discretionary profit-sharing contributions made in fiscal 2006, 2005, or 2004.

The Company also has other 401(k) plans that it sponsors. These plans arose from acquisitions of other companies and the Company's contributions to these plans were not material to the Company on either an individual or aggregate basis for any of the fiscal years presented.

Defined Benefit and Deferred Compensation Plans Assumed from Scientific-Atlanta

Upon completion of the acquisition of Scientific-Atlanta, the Company assumed certain defined benefit plans related to employee pensions and other post-employment benefits. Scientific-Atlanta had a defined benefit pension plan covering substantially all of its domestic employees and defined benefit pension plans covering certain international employees (collectively, the "Pension Plans"); a restoration retirement plan for certain domestic employees (the "Restoration Plan"); supplemental executive retirement plans for certain key officers ("SERPs"); and subsidized health care and life insurance benefits for eligible retirees ("Retiree Medical and Life Plans"). The fair value of the liabilities of these plans was determined at the July 29, 2006 measurement date. The fair value determination of the liabilities reflects the Company's intent to integrate the Scientific-Atlanta employee benefit programs with those of the Company. As a result, no additional benefits will be accrued under the Pension Plans, the Restoration Plan, and the SERPs after February 2008.

The following table sets forth projected benefit obligations, plan assets, and amounts recorded in other long-term liabilities as of July 29, 2006, using July 29, 2006 as a measurement date for all actuarial calculations of asset and liability values and significant actuarial assumptions (in millions):

	Pension Plans	Restoration Plan	SERPs	Total
Projected benefit obligations	$ 146	$ 9	$ 59	$ 214
Fair value of plan assets	(95)	—	—	(95)
Accrued benefit liability	$ 51	$ 9	$ 59	$ 119

Notes to Consolidated Financial Statements

The accumulated benefit obligations under these plans were $199 million as of July 29, 2006 and represent the total benefits earned by active and retired employees discounted at an assumed interest rate. Earned benefits for active employees are based on their current pay and service. The accumulated post-retirement benefit obligations of the Retiree Medical and Life Plans were $12 million as of July 29, 2006 and are unfunded. Significant weighted-average actuarial assumptions for each plan were as follows:

	Pension Plans	Restoration Plan	SERPs	Retiree Medical and Life Plans
Discount rate	5.9%	5.9%	6.4%	6.2%
Rate of compensation increase	5.0%	5.0%	5.0%	N/A

The Company's expected return on plan assets for the Pension Plans is 8.0%. To determine the expected long-term rate of return on the assets for the Pension Plans, the Company considered the historical and expected returns on the plan assets, as well as the current and expected allocation of the plan assets. Plan assets are invested in publicly traded equity securities, fixed income securities, and cash and cash equivalents. The equity portfolio is diversified between domestic growth, value and index components, and an international investment component. The fixed income portfolio is managed by utilizing intermediate-term instruments of high credit quality. The Company's periodic pension cost related to the defined benefit pension plans and post retirement benefits was not material for fiscal 2006. The Company was not required to make any contributions to these plans during fiscal 2006. The Company also assumed deferred compensation plans for certain employees and directors of Scientific-Atlanta. As of July 29, 2006, the deferred compensation liability under these plans was approximately $100 million and was recorded in other long-term liabilities.

11. Income Taxes

The provision for income taxes consists of the following (in millions):

Years Ended	July 29, 2006	July 30, 2005	July 31, 2004
Federal:			
Current	$ 1,877	$ 1,340	$ 968
Deferred	(292)	497	469
	1,585	1,837	1,437
State:			
Current	215	496	230
Deferred	(20)	(292)	(19)
	195	204	211
Foreign:			
Current	304	404	274
Deferred	(31)	(150)	102
	273	254	376
Total	$ 2,053	$ 2,295	$ 2,024

The Company paid income taxes of $1.642 billion, $1.266 billion, and $644 million in fiscal 2006, 2005, and 2004, respectively. Income before provision for income taxes consists of the following (in millions):

Years Ended	July 29, 2006	July 30, 2005	July 31, 2004
United States	$ 2,685	$ 7,028	$ 2,743
International	4,948	1,008	4,249
Total	$ 7,633	$ 8,036	$ 6,992

Notes to Consolidated Financial Statements

The items accounting for the difference between income taxes computed at the federal statutory rate and the provision for income taxes consists of the following:

Years Ended	July 29, 2006	July 30, 2005	July 31, 2004
Federal statutory rate	35.0%	35.0%	35.0%
Effect of:			
State taxes, net of federal tax benefit	1.8	1.8	1.8
Foreign income at other than U.S. rates	(8.7)	(6.7)	(8.3)
Tax audit settlement	(1.6)	(1.4)	—
Other, net	0.4	(0.1)	0.4
Total	26.9%	28.6%	28.9%

The tax provision rate for fiscal 2006 included a benefit of approximately $124 million from the favorable settlement of a tax audit in a foreign jurisdiction. During the fourth quarter of fiscal 2005, the Internal Revenue Service completed its examination of the Company's federal income tax returns for the fiscal years ended July 25, 1998 through July 28, 2001. Based on the results of the examination, the Company has decreased previously recorded tax reserves by approximately $110 million and decreased income tax expense by a corresponding amount. This decrease to the provision for income taxes was offset by increases to the provision for income taxes of $57 million related to a fourth quarter fiscal 2005 intercompany restructuring of certain of the Company's foreign operations and $70 million related to the effect of U.S. tax regulations effective in fiscal 2005 that require intercompany reimbursement of certain stock-based compensation expenses.

U.S. income taxes and foreign withholding taxes associated with the repatriation of earnings of foreign subsidiaries were not provided for on a cumulative total of $11.1 billion of undistributed earnings for certain foreign subsidiaries. The Company intends to reinvest these earnings indefinitely in its foreign subsidiaries. If these earnings were distributed to the United States in the form of dividends or otherwise, or if the shares of the relevant foreign subsidiaries were sold or otherwise transferred, the Company would be subject to additional U.S. income taxes (subject to an adjustment for foreign tax credits) and foreign withholding taxes. Determination of the amount of unrecognized deferred income tax liability related to these earnings is not practicable.

As a result of certain employment and capital investment actions and commitments, the Company's income in certain countries is subject to reduced tax rates, and in some cases is wholly exempt from tax. These tax incentives expire in whole or in part at various times through fiscal 2025.

The following table presents the breakdown between current and noncurrent net deferred tax assets (in millions):

	July 29, 2006	July 30, 2005
Current	$ 1,604	$ 1,475
Noncurrent	915	1,308
Total	$ 2,519	$ 2,783

As of July 29, 2006, the noncurrent net deferred tax assets in the table above consist of $983 million of noncurrent net deferred tax assets included in other assets and $68 million of foreign noncurrent deferred tax liabilities included in other long-term liabilities.

Notes to Consolidated Financial Statements

The components of the deferred tax assets and liabilities are as follows (in millions):

	July 29, 2006	July 30, 2005
ASSETS		
Allowance for doubtful accounts and returns	$ 290	$ 264
Sales-type and direct-financing leases	104	104
Inventory allowances and capitalization	224	239
Investment provisions	273	313
In-process R&D, goodwill, and purchased intangible assets	473	501
Deferred revenue	825	770
Credits and net operating loss carryforwards	526	571
SFAS 123(R) stock-based compensation expense	326	—
Other	652	620
Gross deferred tax assets	3,693	3,382
Valuation allowance	(45)	(85)
Total deferred tax assets	3,648	3,297
LIABILITIES		
Purchased intangible assets	(695)	(189)
Unremitted earnings of foreign subsidiaries	(100)	—
Unrealized gains on investments	(104)	(161)
Depreciation	(185)	(153)
Other	(45)	(11)
Total deferred tax liabilities	(1,129)	(514)
Total net deferred tax assets	$2,519	$2,783

Certain reclassifications have been made to the fiscal 2005 balances for certain components of deferred tax assets and liabilities in order to conform to the current year's presentation.

The valuation allowance decreased from $85 million at July 30, 2005 to $45 million at July 29, 2006. Of the $45 million valuation allowance, $6 million is attributable to acquired deferred tax assets of acquisitions for which any subsequent reduction of this valuation allowance would be applied first to reduce goodwill and then intangible assets of the acquired entity.

As of July 29, 2006, the Company's federal and state net operating loss carryforwards for income tax purposes were $190 million and $2.0 billion, respectively. If not utilized, the federal net operating loss carryforwards will begin to expire in fiscal 2019, and the state net operating loss carryforwards will begin to expire in fiscal 2007. As of July 29, 2006, the Company's federal and state tax credit carryforwards for income tax purposes were approximately $9 million and $543 million, respectively. If not utilized, the federal and state tax credit carryforwards will begin to expire in fiscal 2009.

The Company's income taxes payable for federal, state, and foreign purposes have been reduced by the tax benefits from employee stock options. The Company receives an income tax benefit calculated as the difference between the fair market value of the stock issued at the time of exercise and the option price, tax effected. The net tax benefits from employee stock option transactions were $454 million, $35 million, and $537 million for fiscal 2006, 2005, and 2004, respectively, and were reflected as an increase to additional paid-in capital in the Consolidated Statements of Shareholders' Equity.

The Company's federal income tax returns for fiscal years ended July 27, 2002 through July 31, 2004 are under examination by the Internal Revenue Service. The Company believes that adequate amounts have been reserved for any adjustments which may ultimately result from these examinations.

On October 22, 2004, the American Jobs Creation Act of 2004 (the "Jobs Creation Act") was signed into law. The Jobs Creation Act created a temporary incentive for U.S. corporations to repatriate accumulated income earned abroad by providing an 85 percent dividends received deduction for certain dividends from controlled foreign corporations. In fiscal 2006, the Company distributed cash from its foreign subsidiaries and will report an extraordinary dividend (as defined in the Jobs Creation Act) of $1.2 billion and a related tax liability of approximately $63 million in its fiscal 2006 federal income tax return. This amount was previously provided for in the provision for income taxes and is included in income taxes payable. This distribution does not change the Company's intention to indefinitely reinvest undistributed earnings of certain of its foreign subsidiaries in operations outside the United States.

12. Segment Information and Major Customers

The Company's operations involve the design, development, manufacturing, marketing, and technical support of networking and other products and services related to the communications and other information technology industry. Cisco products include routers, switches, advanced technologies, and other products. These products, primarily integrated by Cisco IOS Software, link geographically dispersed local-area networks (LANs) and wide-area networks (WANs).

The Company conducts business globally and is managed geographically. The Company's management makes financial decisions and allocates resources based on the information it receives from its internal management system. Sales are attributed to a geographic theater based on the ordering location of the customer. The Company does not allocate research and development, sales and marketing, or general and administrative expenses to its geographic theaters in this internal management system because management does not currently use the information to measure the performance of the operating segments. As a result of organizational changes, beginning in fiscal 2006, the Company's reportable segments were changed to the following theaters: United States and Canada; European Markets; Emerging Markets; Asia Pacific; and Japan, and the Company has recast the geographic theater data for the prior fiscal years to reflect this change in reportable segments to conform to the current year's presentation. Prior to fiscal 2006, the Company had four reportable segments: the Americas; Europe, the Middle East, and Africa (EMEA); Asia Pacific; and Japan.

Summarized financial information by theater for fiscal 2006, 2005, and 2004, based on the Company's internal management system, is as follows (in millions):

Years Ended	July 29, 2006	July 30, 2005	July 31, 2004
Net sales:			
United States and Canada	$15,785	$13,298	$11,631
European Markets	6,079	5,692	5,278
Emerging Markets	2,476	1,805	1,450
Asia Pacific	2,853	2,486	2,230
Japan	1,291	1,520	1,456
Total	$28,484	$24,801	$22,045
Gross margin:			
United States and Canada	$10,234	$ 8,784	$ 7,838
European Markets	4,057	3,916	3,661
Emerging Markets	1,682	1,267	1,019
Asia Pacific	1,861	1,671	1,532
Japan	913	1,033	1,076
Total	$18,747	$16,671	$15,126

Net sales in the United States were $15.0 billion, $12.7 billion, and $11.2 billion for fiscal 2006, 2005, and 2004, respectively. The following table presents net sales for groups of similar products and services (in millions):

Years Ended	July 29, 2006	July 30, 2005	July 31, 2004
Net sales:			
Routers	$ 6,005	$ 5,498	$ 5,406
Switches	10,833	9,950	8,838
Advanced technologies	6,228	4,634	3,530
Other	851	771	776
Product	23,917	20,853	18,550
Service	4,567	3,948	3,495
Total	$28,484	$24,801	$22,045

The Company refers to some of its products and technologies as advanced technologies. As of July 29, 2006, the Company had identified nine advanced technologies for particular focus: application networking services, home networking, hosted small-business systems, optical networking, security, storage area networking, unified communications, video systems, and wireless technology. The Company continues to identify additional advanced technologies for focus and investment in the future, and the Company's investments in some previously identified advanced technologies may be curtailed or eliminated depending on market developments. Certain reclassifications have been made to the fiscal 2005 and 2004 balances in order to conform to the current year's presentation.

Notes to Consolidated Financial Statements

The majority of the Company's assets as of July 29, 2006 and July 30, 2005 were attributable to its U.S. operations. In fiscal 2006, 2005, and 2004, no single customer accounted for 10% or more of the Company's net sales. Property and equipment information is based on the physical location of the assets. The following table presents property and equipment information for geographic areas (in millions):

	July 29, 2006	July 30, 2005	July 31, 2004
Property and equipment, net:			
United States	$3,082	$ 2,959	$2,919
International	358	361	371
Total	$3,440	$ 3,320	$3,290

13. Net Income per Share

The following table presents the calculation of basic and diluted net income per share (in millions, except per-share amounts):

Years Ended	July 29, 2006	July 30, 2005	July 31, 2004
Income before cumulative effect of accounting change	$5,580	$ 5,741	$4,968
Cumulative effect of accounting change, net of tax	—	—	(567)
Net income	$5,580	$ 5,741	$4,401
Weighted-average shares—basic	6,158	6,487	6,840
Effect of dilutive potential common shares	114	125	217
Weighted-average shares—diluted	6,272	6,612	7,057
Income per share before cumulative effect of accounting change:			
Basic	$ 0.91	$ 0.88	$ 0.73
Diluted	$ 0.89	$ 0.87	$ 0.70
Per-share amount of cumulative effect of accounting change:			
Basic	$ —	$ —	$ 0.09
Diluted	$ —	$ —	$ 0.08
Net income per share:			
Basic	$ 0.91	$ 0.88	$ 0.64
Diluted	$ 0.89	$ 0.87	$ 0.62

Dilutive potential common shares consist primarily of employee stock options and restricted common stock. Employee stock options to purchase approximately 1.0 billion, 847 million, and 469 million shares in fiscal 2006, 2005, and 2004, respectively, were outstanding, but were not included in the computation of diluted earnings per share because the effect would have been antidilutive.

14. Subsequent Events

Acquisition of Meetinghouse Data Communications, Inc.

As of July 29, 2006, the Company announced a definitive agreement to acquire privately held Meetinghouse Data Communications, Inc. The aggregate announced purchase price for this acquisition was approximately $44 million in cash. The acquisition closed in the first quarter of fiscal 2007.

Investment in Nuova Systems, Inc.

In the first quarter of fiscal 2007, the Company made an investment in Nuova Systems, Inc. ("Nuova Systems"), which conducts research and development on data center-related products. As a result of this investment, the Company owns approximately 80% of Nuova Systems and will consolidate the results of Nuova Systems in the Company's Consolidated Financial Statements beginning in the first quarter of fiscal 2007. This investment includes $50 million of funding and a license to certain of the Company's technology. In addition, upon the occurrence of certain events, the Company has committed up to an additional $42 million of funding to Nuova Systems beginning in the second quarter of fiscal 2008.

In connection with this investment, the Company and Nuova Systems have entered into a call option agreement that provides the Company with the right to purchase the remaining interests of approximately 20% in Nuova Systems. If exercised by the Company, the call option provides that the minority interest holders would be eligible to receive two milestone payments based on a revenue formula set forth in the call option agreement. The amounts due under the milestone payments will be recognized by the Company when it is determined that the exercise of the call option is probable and payments will be made. These amounts will be recorded as compensation expense based on an estimate of the fair value of the amounts earned by the minority interest holders pursuant to a vesting schedule. If the Company exercises the call option, the potential amounts that would be paid on the milestone dates would be a minimum of $10 million and a maximum of $578 million, beginning in fiscal 2008 and ending in fiscal 2009.

Supplementary Financial Data (Unaudited)
(in millions, except per-share amounts)

Quarters Ended	July 29, 2006	Apr. 29, 2006	Jan. 28, 2006	Oct. 29, 2005	July 30, 2005	Apr. 30, 2005	Jan. 29, 2005	Oct. 30, 2004
Net sales	$ 7,984	$ 7,322	$ 6,628	$ 6,550	$ 6,581	$ 6,187	$ 6,062	$ 5,971
Gross margin	$ 5,145	$ 4,726	$ 4,466	$ 4,410	$ 4,468	$ 4,135	$ 4,053	$ 4,015
Net income(1)	$ 1,544	$ 1,400	$ 1,375	$ 1,261	$ 1,540	$ 1,405	$ 1,400	$ 1,396
Net income per share—basic	$ 0.25	$ 0.23	$ 0.22	$ 0.20	$ 0.24	$ 0.22	$ 0.21	$ 0.21
Net income per share—diluted	$ 0.25	$ 0.22	$ 0.22	$ 0.20	$ 0.24	$ 0.21	$ 0.21	$ 0.21
Cash and cash equivalents and investments	$17,814	$18,183	$14,989	$13,490	$16,055	$16,149	$16,525	$17,727

(1) Net income for the first quarter of fiscal 2006 included stock-based compensation expense under SFAS 123(R) of $253 million, net of tax, which consisted of stock-based compensation expense of $228 million, net of tax, related to employee stock options and employee stock purchases and stock-based compensation expense of $25 million, net of tax, related to acquisitions and investments. Net income for the first quarter of fiscal 2005 included stock-based compensation expense of $38 million, net of tax, related to acquisitions and investments.

Net income for the second quarter of fiscal 2006 included stock-based compensation expense under SFAS 123(R) of $210 million, net of tax, which consisted of stock-based compensation expense of $188 million, net of tax, related to employee stock options and employee stock purchases and stock-based compensation expense of $22 million, net of tax, related to acquisitions and investments. Net income for the second quarter of fiscal 2005 included stock-based compensation expense of $34 million, net of tax, related to acquisitions and investments.

Net income for the third quarter of fiscal 2006 included stock-based compensation expense under SFAS 123(R) of $209 million, net of tax, which consisted of stock-based compensation expense of $188 million, net of tax, related to employee stock options and employee stock purchases and stock-based compensation expense of $21 million, net of tax, related to acquisitions and investments. Net income for the third quarter of fiscal 2005 included stock-based compensation expense of $43 million, net of tax, related to acquisitions and investments.

Net income for the fourth quarter of fiscal 2006 included stock-based compensation expense under SFAS 123(R) of $164 million, net of tax, which consisted of stock-based compensation expense of $152 million, net of tax, related to employee stock options and employee stock purchases and stock-based compensation expense of $12 million, net of tax, related to acquisitions and investments. Net income for the fourth quarter of fiscal 2005 included stock-based compensation expense of $34 million, net of tax, related to acquisitions and investments.

There was no stock-based compensation expense related to employee stock options and employee stock purchases under SFAS 123 in fiscal 2005 because the Company did not adopt the recognition provisions of SFAS 123.

Stock Market Information

Cisco common stock is traded on the NASDAQ Global Select Market under the symbol CSCO. The following table lists the high and low sales prices for each period indicated:

Fiscal	2006		2005	
	High	Low	High	Low
First quarter	$ 19.74	$ 16.83	$ 21.24	$ 17.53
Second quarter	$ 19.43	$ 16.87	$ 20.35	$ 17.41
Third quarter	$ 22.00	$ 17.82	$ 18.80	$ 17.01
Fourth quarter	$ 22.00	$ 17.45	$ 20.25	$ 17.16

The Company has never paid cash dividends on its common stock and has no present plans to do so. There were 77,991 registered shareholders as of September 8, 2006.

Shareholder Information

Directors and Officers

Directors

Carol A. Bartz[3] [5]
Executive Chairman of the Board
Autodesk, Inc.

M. Michele Burns[1] [2]
Executive Vice President and
Chief Financial Officer
Marsh & McLennan Companies, Inc.

Michael D. Capellas[3]
Former President and Chief Executive Officer
MCI, Inc.

Larry R. Carter[4]
Senior Vice President, Office of the President
Cisco Systems, Inc.

John T. Chambers[1]
President and Chief Executive Officer
Cisco Systems, Inc.

John L. Hennessy, Ph.D. [1] [6]
President
Stanford University

Richard M. Kovacevich [5]
Chairman and Chief Executive Officer
Wells Fargo & Company

Roderick C. McGeary[2]
Chairman of the Board
BearingPoint, Inc.

James C. Morgan[3] [4] [5]
Chairman of the Board
Applied Materials, Inc.

John P. Morgridge[1] [4]
Chairman of the Board
Cisco Systems, Inc.

Steven M. West[2] [4]
Founder and Partner
Emerging Company Partners, LLC

Jerry Yang [3] [6]
Cofounder, Chief Yahoo! and Director
Yahoo! Inc.

(1) Member of the Acquisition Committee
(2) Member of the Audit Committee
(3) Member of the Compensation and Management Development Committee
(4) Member of the Investment/Finance Committee
(5) Member of the Nomination and Governance Committee
(6) Member of the Technology Committee

Executive Officers

Susan L. Bostrom
Senior Vice President, Chief Marketing Officer
Worldwide Government Affairs

Larry R. Carter
Senior Vice President, Office of the President

Jonathan Chadwick
Vice President, Corporate Controller,
and Principal Accounting Officer
(as of September 20, 2006)

John T. Chambers
President and Chief Executive Officer

Mark Chandler
Senior Vice President, Legal Services, General Counsel, and Secretary

Charles H. Giancarlo
Senior Vice President, Chief Development Officer

Richard J. Justice
Senior Vice President, Worldwide Field Operations

Randy Pond
Senior Vice President, Operations, Processes and Systems

Dennis D. Powell
Senior Vice President and Chief Financial Officer

Betsy Rafael
Vice President, Corporate Controller, and Principal Accounting Officer (until September 20, 2006)

James Richardson
Senior Vice President, Commercial Business

Other Senior Vice Presidents

Nick Adamo
Senior Vice President, U.S. Service Provider Sales

Anthony J. Bates
Senior Vice President, Service Provider Routing Technology Group

Joel P. Bion
Senior Vice President, Research and Advanced Development

Brad Boston
Senior Vice President, Chief Information Officer and Government Solutions

R. Gary Bridge
Senior Vice President, Internet Business Solutions Group

Owen Chan
Senior Vice President, Asia Pacific

Howard Charney
Senior Vice President, Office of the President

Chris Dedicoat
Senior Vice President, European Markets

Doug Dennerline
Senior Vice President, U.S. Commercial Sales

Carlos Dominguez
Senior Vice President, Worldwide Service Provider Operations

Thomas Edsall
Senior Vice President, Data Center Business Unit

Wim Elfrink
Senior Vice President, Customer Advocacy

Keith E. Goodwin
Senior Vice President, Worldwide Channels

Kathryn M. Hill
Senior Vice President, Ethernet Systems Group

Yasuki Kurosawa
Senior Vice President, Japan

Michel Langlois
Senior Vice President, Network Software and Systems Technology Group

Robert Lloyd
Senior Vice President, U.S. and Canada Operations

John F. McCool
Senior Vice President, Internet Systems Business Unit

James F. McDonald
Scientific Atlanta President and Chief Executive Officer

Clifford B. Meltzer
Senior Vice President, Network Management Technology Group

Angel Mendez
Senior Vice President, Worldwide Manufacturing

Gary B. Moore
Senior Vice President, Advanced Services

Paul Mountford
Senior Vice President, Emerging Markets

George O'Meara
Senior Vice President, Customer Advocacy, U.S. and Canada Theater

Richard W. Palmer, Jr.
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Pankaj S. Patel
Senior Vice President, Service Provider Routing Technology Group

Ian D. Pennell
Senior Vice President, Access Technology Group

Joseph Pinto
Senior Vice President, Technical Support Services

J. Michael Pocock
Linksys Senior Vice President and General Manager

Donald R. Proctor
Senior Vice President, Voice Technology Group

Carl Redfield
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Manny Rivelo
Senior Vice President, Worldwide Field Process and Technical Operations

Daniel Scheinman
Senior Vice President, Corporate Development

Jim Sherriff
Senior Vice President, U.S. Enterprise Sales

Janie C. Tsao
Senior Vice President, New Markets

Victor Tsao
Senior Vice President, New Markets

Jayshree Ullal
Senior Vice President, Data Center, Switching and Security Technology Group

Michelangelo Volpi
Senior Vice President, Routing and Service Provider Technology Group

Shareholder Information

Online Annual Report

Visit our online interactive report at **www.cisco.com/annualreport/2006** to find our shareholders' letter in multiple languages, the full 2006 Annual Report, and additional company and product information.

To receive all shareholder information exclusively online, register at: **www.icsdelivery.com/cisco.**

Cisco's stock trades on the NASDAQ Global Select Market under the ticker symbol CSCO.

Investor Relations

For further information about Cisco, additional copies of this report, Form 10-K, or other financial information without charge, contact:

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Independent Registered Public Accounting Firm

PricewaterhouseCoopers LLP
San Jose, California

Legal Counsel

Fenwick & West LLP
Mountain View, California

Notice of Annual Meeting

Santa Clara Convention Center
Exhibit Hall A
5001 Great America Parkway
Santa Clara, CA 95054
Wednesday, November 15, 2006
10 a.m. Pacific Time

Corporate Information

Company Profile

Networks are an essential part of life's experiences, helping to connect people in business, education, government, and the home.

Founded in 1984, Cisco has led in the innovation of Internet Protocol (IP)-based networking technologies. This tradition continues with the development of routing and switching and numerous advanced technologies: application networking services, home networking, hosted small-business systems, security, storage area networking, unified communications, video systems, and wireless.

Cisco and its valued partners sell Cisco hardware, software, and services to businesses of all sizes, governments, service providers, and consumers.

An integral part of Cisco's business strategy is strong corporate citizenship. Responsible business practices help ensure accountability, business sustainability, and commitment to environmentally conscious operations and products. Social investments built upon partnerships with local organizations positively impact recipient communities around the world. As an expression of our company values and beliefs, these activities are designed to build trust in our company and empower our employees.

Learn more at www.cisco.com.

Worldwide Offices

Corporate Headquarters	European Headquarters	Americas Headquarters	Asia Pacific Headquarters
San Jose, California, USA	Amsterdam, Netherlands	San Jose, California, USA	Singapore

Cisco Systems has offices in the following countries and regions. Addresses, phone numbers, and fax numbers are listed on the Cisco Website at www.cisco.com/go/offices.

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Forward-Looking Statements

This Annual Report contains forward-looking statements regarding future events and our future results that are subject to the safe harbors created under the Securities Act of 1933 and the Securities Exchange Act of 1934. These statements are based on current expectations, estimates, forecasts, and projections about the industries in which we operate and the beliefs and assumptions of our management. Words such as "expects," "anticipates," "targets," "goals," "projects," "intends," "plans," "believes," "seeks," "estimates," "continues," "may," variations of such words, and similar expressions are intended to identify such forward-looking statements. In addition, statements that refer to: projections of our future financial performance, our business strategy, our anticipated growth and trends in our businesses or key markets, including the commercial market segment; integration of our product architectures; future growth opportunities; investments in resources, new advanced technologies, and emerging geographic markets; and other characterizations of future events or circumstances are forward-looking statements. Readers are cautioned that these forward-looking statements are only predictions and may differ materially from actual future events or results due to a variety of factors, including: business and economic conditions and growth trends in the networking industry and in various geographic regions; global economic conditions and uncertainties in the geopolitical environment; overall information technology spending; the growth of the Internet and levels of capital spending on Internet-based systems; variations in customer demand for products and services, including sales to the service provider market; the timing of orders and manufacturing and customer lead times; changes in customer order patterns or customer mix; insufficient, excess, or obsolete inventory; variability of component costs; variations in sales channels, product costs, or mix of products sold; our ability to successfully acquire businesses and technologies and to successfully integrate and operate these acquired businesses and technologies including the businesses and technologies of Scientific-Atlanta, Inc.; increased competition in the networking industry; dependence on the introduction and market acceptance of new product offerings and standards; rapid technological and market change; manufacturing and sourcing risks, including risks relating to our transition to a new manufacturing model; product defects and returns; litigation involving patents, intellectual property, antitrust, shareholder, and other matters; natural catastrophic events; a pandemic or epidemic; achievement of the benefits anticipated from our investments in sales and engineering activities; our ability to recruit and retain key personnel; our ability to manage financial risk; currency fluctuations and other international factors; potential volatility in operating results and other factors listed in Cisco's most recent reports on Form 10-K, 10-Q, and 8-K. The financial information contained in this Annual Report should be read in conjunction with the consolidated financial statements and notes thereto that are included in this report. Our results of operations for the year ended July 29, 2006 are not necessarily indicative of our operating results for any future periods. We undertake no obligation to revise or update any forward-looking statements for any reason.

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